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BOB STUMP, CHAIRMAN
GARY PIERCE
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BOB BURNS
SUSAN BITTER SMITH

IN THE MATTER OF THE APPLICATION OF CHAPARRAL CITY WATER COMPANY FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTLITY PLANT AND PROPERTY AND FOR INCREASE IN ITS RATES AND CHARGES BASED THEREON.

DOCKET NO. W-02113A-13-0118

NOTICE OF FILING CORRECTED STAFF OPENING BRIEF

Commission Staff hereby files a corrected version of the Staff Opening Brief filed on April 4, 2014. The corrections relate to the brief's footnotes, which due to a word processing software issue were either incomplete or not reconciled appropriately to the text. The text was then reformatted, but no substantive changes were made.

RESPECTFULLY SUBMITTED this 7th day of April, 2014.

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BEFORE THE ARIZONA CORPORATION COMMISSION

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I. INTRODUCTION.

The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission" or "ACC") hereby files its opening brief in the above captioned matter. Staff maintains its position as presented in its testimony on any issue not specifically addressed here.

Chaparral City Water Company ("CCWC" or "Company"), is an Arizona public service corporation engaged in providing water utility services in portions of Maricopa County, Arizona, pursuant to certificate of convenience and necessity granted by the Commission. CCWC is a wholly owned subsidiary of Edmonton Power Corporation ("EPCOR") Water (USA) Inc. ("EWUS"). CCWC filed an application for a rate increase in the above captioned matter on April 26, 2013. During the 2012 Test Year, CCWC served approximately 13,567 customers.[1]

The Company's present rates and charges for utility service were approved by the Commission in Decision No. 72258 (April 7, 2011) using a test year ending December 31, 2006. In its final schedules, the Company requests a rate increase of $2,907,929 over its test year revenues of $9,014,985.[2] This would result in an increase of 32.6 percent for a total revenue requirement of

[1] Lenderking Dir. Test., Ex. A-25 at 16.
[2] Company's Final Schedule C-1.

$11,823,580. The Company bases its request on a 9.85 percent rate of return on its $27,295,481 fair value rate base ("FVRB") which is also its original cost rate base ("OCRB")[3]

Staff recommends a 7.9 percent return on the $26,782,933 Staff-adjusted FVRB and OCRB. Staff's proposed water rates produce total operating revenue of $10,319,310, an increase of $1,304,325, or 14.47 percent, over the adjusted test year revenue of $9,014,985 to provide $2,115,852 in operating income.

The Residential Utility Consumer Office ("RUCO") recommends water rates that produce total operating revenue of $9,835,885 an increase of $754,940 or 8.31 percent over the adjusted test year revenue of $9,080,945 to provide $1,950,566 in operating income. RUCO's rates are based on a 7.98 percent return on the $24,443,178 RUCO-adjusted FVRB and OCRB.[4]

II. UNRESOLVED RATE BASE AND OPERATING INCOME ISSUES.

A. Rate Base Adjustments.

At the commencement of the hearing, the remaining issues regarding rate base adjustments related to plant, accumulated depreciation, working capital and deferred debits. At hearing, the Company submitted Exhibit A-8 which eliminated differences regarding plant and accumulated depreciation. The final schedules submitted by CCWC on March 7, 2014, now reflect plant and accumulated depreciation balances of $70,206,985 and $25,320,747, respectively, and these amounts effectively agree with those recommended by Staff in its final schedules. On that basis, it now appears that Staff and CCWC are in agreement as to the original cost rate base, except as to working capital and deferred debits. However, the agreement reached regarding plant and accumulated depreciation amounts does not resolve differences regarding the calculation of depreciation expense because the Company utilized revised depreciation rates while retaining the group method to recalculate its proposed depreciation expense. Staff continues to recommend the vintage year methodology as used in prior Commission cases, and does not change the stated depreciation rates.

[3] Company's Final Schedule A-1.
[4] RUCO's Final Schedule JMM-1.

1. Working capital.

In calculating working capital, CCWC previously included approximately $780,000 of required bank balances related to existing financing,[5] though the Company was seeking approval to refinance that debt.[6] Decision No. 74388, issued March 19, 2014, has now authorized the refinancing. Under the new financing, no bank balances are required and this amount can be eliminated.[7] In its final schedules, the Company has done so.[8] Therefore, the only remaining issue regarding working capital is the amount of cash working capital.

The rate base differences between Staff's and the Company's respective calculations of working capital involves the cash working capital component of working capital. In final schedules, the Company and Staff indicate cash working capital amount of $(87,149)[9] and $(126,234),[10] respectively, for a difference of $39,085. This difference is the result of disputed levels of expenses related to purchased water, purchased power, and chemicals associated with excess water loss; disputed amounts related to corporate allocations (incentive compensation); differences in the estimated reduction to outside services related to audit fees that will no longer be needed with the refinancing of the IDA bonds; the Company's inclusion of rate case expense; differing levels of bad debt expense included in the customer accounting expense (related to differing levels of revenue increase); different levels of interest expense due to differences in the capital structure; different levels of income taxes due to different revenues; and different levels of property taxes due to both different levels of revenue along with differences in the assessment ratios.

Of these differences, the only non-conforming amounts relate to the inclusion of rate case (regulatory) expense and the amount of interest expense. Staff does not include regulatory expense in its cash working capital calculation.

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[5] Tr. Vol. V at 809-810.
[6] Hubbard Reb. Test., Ex. A-6 at 17-18.
[7] Tr. Vol. V at 809-810.
[8] Company's Final Schedule B-5.
[9] *Id.*
[10] Staff's Final Schedule GWB-9, line 34.

CCWC's proposed amount of interest expense is based on the Company's reported interest expense[11] reflected by its proposed capital structure. Staff's recommendation is based on the Staff's hypothetical capital structure used in its cost of capital analysis. The capital structure is also discussed elsewhere in the brief. Staff recommends the use of a more appropriate capital structure that has several implications and benefits for the ratepayers. First, it affects the overall rate of return. Second, the higher interest expense reduces the cash working capital. Third, the higher interest expense also decreases the amount of income taxes borne by the rate payers.

If the Commission adopts a hypothetical capital structure for cost of capital, it should treat the interest expense in a consistent manner. In this case, during the 2012 test year, the parent company had a capital structure consisting of 46 percent debt and 54 percent equity,[12] compared to CCWC's proposal which reflects 14 percent debt and 86 percent equity. In acquiring CCWC, the parent used funds which reflected the parent's 46 percent debt to 54 percent equity ratio but recorded CCWC as a 14 percent debt to 86 percent equity ratio, to the advantage of the Company and disadvantage of the ratepayers. The cost of equity is higher than the cost of debt[13] and has tax consequences. By proposing a greater portion of equity to the regulated utility, the regulated utility would not recognize its proportionate share of interest expense, and this results in a higher cash working capital requirement to the utility. Further, understating the (synchronized) interest expense results in a higher income tax liability.[14] The parent is able to recover that higher cost for both working capital and income tax expense from the ratepayer while reducing costs borne by the shareholders of the parent. Sharing the interest expense on debt at the parent level represents a fairer allocation of costs between shareholders and ratepayers.

2. 24 Month Deferral Request.

CCWC proposes what it terms a 'deferral mechanism' to allow the deferral of AFUDC financing and depreciation on plant placed in service during the 24 month period beginning the first

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[11] Hubbard Reb. Test., Ex. A-6 at 17.
[12] Parcell Surr. Test., Ex. R-9 at 18.
[13] Tr. Vol. II at 248.
[14] Tr. Vol. V at 878.

day of the test year, January 1, 2012.[15] In its final schedules, the Company and Staff schedules indicate Deferred Debits of $551,668[16] and $78,206,[17] respectively, for a difference of $473,462, which reflects the revised amount of actual plant during the proposed 24 month deferral period.[18] This revised amount corresponds to the $607,898 recommended to be removed by Staff from the Company's original amounts.[19]

Staff opposes the deferral and recommends its rejection. CCWC acknowledges that its sole support for its proposal for the 24 month deferral, designed to address regulatory lag, was based on a Staff Memorandum submitted in Docket No. 09-0077 on March 19, 2012.[20] That Staff report was authored by Staff witness in this case, Gerald Becker, and resulted from a series of workshops conducted in 2010 and 2011.[21] Those workshops were intended to address alternative methods of financing to help achieve the Commission's objectives of encouraging the acquisition of troubled water companies and developing a regional infrastructure.[22] As discussed by Mr. Becker at hearing, the 24 month deferral mechanism was recommended by Staff at that time as an alternative to a DSIC mechanism that was then being considered. [23] That recommendation has never been adopted by the Commission[24] and the Commission has subsequently adopted the SIB in lieu of a DSIC in other cases.[25] Since Staff is recommending the approval a SIB in this case, it deems this mechanism unnecessary and inappropriate. Moreover, at hearing, Staff also noted that the Company did not provide adequate reasons to justify the 24 month deferral mechanism.[26]

Although the 24 month deferral was recommended by Staff *in lieu of,* not in addition to, a DISC-type mechanism,[27] the Company argues that the SIB and the 24 month deferral are different

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[15] Tr. Vol. I at 92; Broderick Dir. Test., Ex. A-3 at 21-22.
[16] Company's Final Schedule, B-1 at 1.
[17] Staff's Final Schedule GWB-3.
[18] Hubbard Reb. Test., Ex. A-6 at 15.
[19] Staff's Final Schedule, GWB-3.
[20] Broderick Dir. Test., Ex. A-3 at 22.
[21] Tr. Vol. V at 921.
[22] Exhibit A-33, Staff Report in Global Water Docket No. SW-02445A-09-0077, et al.
[23] Tr. Vol. V at 829.
[24] *Id.* at 925.
[25] Global Water Co. (Dec. No. 94364); Arizona Water Co. (Dec. No. 73938).
[26] Tr. Vol. V at 922-233.
[27] *Id.* at 923.

mechanisms because they address different plant. (The SIB addresses plant added after a rate case; the 24-month deferral concerns plant added during the 24 months of the test year and the pending rate case.)[28] Staff's recommendation is not based on whether the mechanisms addressing the same plant or different plant, nor did Staff verify whether the same plant is covered by both.[29] Staff's concerns are not alleviated by the Company's contention that the two mechanisms address different plant because the 24 month deferral was recommended by Staff *in lieu of,* not in addition to, a DISC-type mechanism.[30] Instead, the Commission adopted the SIB, which the Company is also requesting.

B. OPERATING INCOME & EXPENSE ADJUSTMENTS.

1. Excess Water Loss.

CCWC experienced a water loss of 13.9 percent during the test year,[31] which exceeds the allowable limits by 3.9 percent. Staff recommends that any expenses related to water loss in excess of 10 percent be proportionately eliminated. These expenses include the cost of purchased CAP water, fuel, power expenses and chemical costs. Staff has calculated adjustments related to excess water loss to be:

Cost of purchased CAP water	$39,598
Fuel & power expenses	$20,746
Chemical costs	$ 4,084

CCWC opposes these adjustments saying that it is unfair to reduce expenses actually incurred in providing safe and reliable water service to customers when the Company is making efforts to correct the water loss problem.[32] However, it should be noted that these expenses do not benefit customers and should not be included in rates. The ability to control water loss rests solely with the Company and outside the control of customers. Requiring the customers to bear such an expense is fundamentally unfair. It should also be noted that in this case, the Company is requesting and Staff is recommending the approval of a SIB, an express purpose of which is to enable the Company to add

[28] Hubbard Reb. Test., Ex., A-6.
[29] Tr. Vol. V at 925-926.
[30] *Id.* at 923.
[31] Tr. Vol. III at 567.
[32] Murrey Rebuttal Test., Ex. A-30 at 2.

or improve plant in order to reduce water loss. Thus we can expect water loss to be reduced in the near future.[33]

It is noteworthy that CCWC does not oppose Staff's adjustment as to the cost of purchased water reflecting the increase in rates paid for CAP water since the test year. This adjustment results in an additional $90,524.[34] When the amount of water purchased is adjusted for excess water loss, this amount is reduced by $39,598, resulting in a net increase of $50,926 as shown in Staff's Final Schedules.[35] By recognizing both the increases to the cost of purchased water and the costs associated with excess water, the net result is one that is fair to both CCWC and its ratepayers.

2. Intercompany Support Services (Incentive Pay.)

The Company proposes an expense of $89,517 in incentive compensation paid to employees. However, the Company did not meet its burden of proof regarding the basis on which these amounts were paid, and the resulting extent to which these amounts benefitted the ratepayers. The incentive compensation plan is based on the possible attainment of certain financial and operational goals. The Company acknowledges that its incentive pay plan includes a financial component, which inures solely to the benefit of shareholders, in addition to efficiency and safety components.[36] The Company argues that because such a small portion of the computation of the payment amount is to be related to financial incentives and the plan benefits customers generally, the entire amount should be recovered in rates.

Staff disagrees. First, the 10 percent policy reflects the criteria on which the Company might possibly pay in incentive payments as a result of the Company's financial performance. However, the Company did not provide data necessary to support the breakdown of the components (i.e. operational versus financial goals) used in its calculations of actual amounts paid. Records of the calculations would be required to determine the basis for the actual payments and to allocate the

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[33] Tr. Vol. III at 567.
[34] Becker Dir. Test., Ex. S-8 at 21.
[35] Staff's Final Schedules, GWB-10.
[36] Hubbard Reb. Test., Ex. A-6 at 23.

benefit between shareholders and customers.[37] Despite Staff's request for those records, they were not produced.

Moreover, in the event that the Company had provided the support for its incentive payments, it has not established that the non-financial components are to the customers' sole benefit. Staff would further suggest that both efficiency and safety goals serve the shareholders as well as the customers, particularly in preventing fines and liability related to safety deficiencies. Without this information, the proposed amounts to be borne by ratepayers cannot be quantified or justified.

3. External Audit Fees.

CCWC had included external audit fees in the Outside Services category in the amount of $49,813.[38] Since this expense is related to audit requirements for debt that has been refinanced, the audit requirement has ceased. In its final schedules, CCWC removes an estimated $46,000 from outside services, as discussed at hearing. Staff removes $49,813 on Schedule GWB-11.

4. Depreciation and Amortization Expense.

According to the parties' final schedules, the total annual depreciation and amortization expenses are as follows:

CCWC	$1,688,127
Staff	$1,684,940
RUCO	$1,666,846

In this case, the components of the depreciation and amortization expense consider the usual depreciation and amortization expense associated with plant and contributions in aid of construction; the amortization of the deferral of 50 percent of the M&I charges over a five year period; amortization of the Company's proposed deferral of post-in-service AFUDC and Deferred Depreciation at the Company's proposed composite depreciation rate; and, the amortization of the gain of $1,520,000 on the sale of property transferred to the Fountain Hills Sanitary District ($76,000, to be amortized over 10 years).[39]

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[37] Becker Sur. Test., Ex. S-10 at 5-6.
[38] Staff's Final Schedule GWB-10.
[39] Company's Final schedule at C-2.

Staff's final amount for the depreciation and amortization expense of $1,684,940 is reflected on Staff's final schedule GWB-16. Staff's amount includes depreciation on plant; depreciation on post-test year plant; and the amortization of deferred CAP costs, less amortization of CIAC and less the amortization of the gain on the Fountain Hills settlement. Staff and the Company continue to disagree on the inclusion of amortization associated with the deferral of post-in-service AFUDC and Deferred Depreciation. Staff and Company disagree on depreciation expense methodologies and the amount of depreciation expense to be recorded on Account 311 Pumping Equipment and Account 341 Transportation Equipment. The principal difference between Staff's and the Company's amount is related to the depreciation methods used by each.[40]

Staff identified two plant accounts which included components that had been fully depreciated and recovered, but remained in service the Company's depreciation method. These plants accounts continue to accrue depreciation expense. As discussed in Staff's Direct Testimony,[41] Staff is recommending that the Company employ the vintage year group method of depreciation ("vintage year method"). The Company states that it currently employs the group method of depreciation ("group method") and proposes that it continue using that methodology.[42]

As is clear in this case, the fundamental problem with the group method is that it allows plant to be depreciated beyond its original cost. Under the group method, once plant is added, it continues to be depreciated until it is retired, regardless of whether the cost of the plant has been fully recovered in rates.[43] The Company asserts that it should be allowed to collect depreciation expense on plant as long as it remains in service, regardless of any over collection of the original cost.[44] The Company also asserts that this method assumes that some plant will be retired prior to the end of its expected life, while other plant will outlast its expected life and continue to accrue depreciation, and that the resulting over and under recoveries will average out.[45] However, no evidence has been presented to

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[40] Tr.Vol. V at 870.
[41] Becker Amended Sur. Test., Ex. S-11 at 4.
[42] Tr. Vol. V at 765–766.
[43] Tr. Vol. 1 at 71.
[44] *Id.* at 75.
[45] Tr. Vol. V at 818.

support this assumption. Nor have any instances of under-recovery in any group been shown in this case. Hence, there remains a risk that over-depreciation will occur.

The group method is also problematic because it creates a mismatch between the actual useful life of new plant investments and the time period over which these new investments are recovered through rate-recognized depreciation expense.[46] As the Company concedes, the group method of depreciation does not keep track of the year that an individual asset within the group is placed in service.[47] Rather, the group method lumps assets together, regardless of the year any asset was put in service, and calculates depreciation expense on those assets as long as they are in service.[48] This mismatch is inconsistent with the widely accepted ratemaking principle of recovering only the cost of the asset through rates.[49] This mismatch conflicts with NARUC's Uniform System of Accounts ("USOA").[50] Under Staff's vintage year method, the recovery through depreciation expense is more accurately matched to the original cost of the asset and provides for more appropriate recovery. This is accomplished by tracking the vintage year when assets are acquired and analyzing the extent to which those costs have been recovered.

The ACC has the authority under A.R.S. § 40-222, as well as its exclusive and plenary constitutional ratemaking authority, to prescribe depreciation methodology.[51] The Commission has adopted a rule that, in maintaining a utility's accounts and records related to depreciation practices, "the cost of depreciable plant adjusted for net salvage shall be distributed in a rational and systemic manner over the estimated service life of such plant."[52] No specific methodology is mandated, nor is any compliance mandated with any NARUC publications. What is required is that the methodology be rational and systematic, and the rates be just and reasonable.

The Company has asserted that Staff's recommended vintage year methodology does not appear to have been 'thought through completely,' because Staff's vintage year method differs from

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[46] *See* New River Utility Co., Dec. No. 74294.
[47] Tr. Vol. V at 818.
[48] *See* New River Utility Co., Dec. No. 74294.
[49] *Id.*
[50] *Id.*
[51] *Id.*
[52] A.A.C. R14-2-102(B).

the vintage group method described in *Public Utility Depreciation Practices* ("manual") of 1996.[53] Among these alleged inconsistencies is that, in that manual, under the vintage group method, plant does continue to be depreciated until it is retired, regardless of any over-recovery.[54] Staff, however, did not base its proposed methodology on that described in manual and has not suggested that the vintage group method as described therein be utilized here.

While the Company contends that Staff's recommendation lacks technical merit, that manual to which it cites actually supports Staff's position in that, as the Company itself concedes, the Manual is not intended to prescribe only certain approved methods.[55] It states:

> Generally accepted accounting does not require any specific method to determining depreciation expense. It only requires that the method used to allocate the cost of assets to accounting periods be systematic and rational. Thus, a variety of methods are encountered in accounting practices.... Depending on the circumstances of each case, all of these methods will produce acceptable results and will meet the general test of being *systematic* and *rational*.[56] (emphasis added.)

The need for depreciation methods to be "systematic and rational" cannot be over emphasized. In this case, the basic question is whether the ACC should continue to allow over recovery that has been identified. The Manual specifically acknowledges that some state commissions have disallowed such methods for both practical and technical reasons.[57]

Staff's vintage year method has been under consideration for several years, and reflects the same methodology which Staff has previously recommended in a number of cases.[58] Mr. Becker testified that the vintage year method proposed here was based on the same method as the Commission recently adopted in Decision No. 74292, regarding New River Utility Company. Although part of the consideration in that case was that Company's poor recordkeeping (which does not appear to be a factor in this case) the Commission determined that "the broad group model easily lends itself to overstating the remaining cost of a plant group and thus overstating depreciation

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[53] Tr. Vol. V at 801-02.
[54] Tr. Vol. V at 802.
[55] Tr. Vol. V at 809.
[56] Exhibit A-32, Public Utility Depreciation Practices, NARUC, 1996 at 43.
[57] *Id.*
[58] *See* Bella Vista Water, Dec. No. 72251; Rio Rico Util., Dec. No. 73996.

expense."[59] To continue using that method was deemed not to be in the public interest or that of the Company's ratepayers.[60] The Commission also recognized that "the vintage year method is consistent with the straight-line method required by the NARUC USOA" and that it "will result in a rational and systemic depreciation methodology consistent with the Commission's rules."[61] Thus, Staff's vintage year method meets NARUC and Commission requirements.

The Company also acknowledges the risk of over-collection. On the last day of hearing, the Company indicated reduced depreciation rates for the two accounts in question.[62] In its most recent schedules, the Company it adjusts depreciation expense by $228,514 [63] by changing its depreciation rates. The change helps to more closely match the expected lives of those accounts with their recovery, yet differences regarding the methodology remain. While The Company's adjustment could mitigate the risk of over-collection, Staff disagrees that this would adequately eliminate the risk of over-depreciation.[64] In fact, the Commission rejected a similar proposal to address over collection in the New River Decision.[65] The best means of achieving that goal, and the simplest, is to require the Company to cease depreciation on fully depreciated plant on a vintage year basis.

In its opposition to the vintage year method, the Company asserts that changing to vintage year depreciation would be overly burdensome, both in time and costs expended.[66] It argues that, if it is ordered to use Staff's method for CCWC, all of EPCOR will also be required to change methodology, and Ms. Hubbard estimates the cost to make these changes throughout EPCOR's organization would be approximately $500,000 for all of its systems. However, insufficient evidence has been provided to support either the need for all of EPCOR to change its methodology or the cost of such a change. Ms. Hubbard acknowledges that the $500,000 is merely a 'rough estimate.'[67]

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[59] Decision No. 74294 at 18.
[60] *Id.*
[61] *Id.* at 19.
[62] Tr. Vol. V at 776-777; 853-854.
[63] Company's Final Schedules, C-2
[64] Tr. Vol. V at 950-951.
[65] Decision No. 74294 at 19.
[66] Tr. Vol. V at 790-792.
[67] *Id.* at 800.

While Staff is not prejudging the estimated amounts that might be required to be spent, Staff points out that whatever the actual cost, it would be allocated among all of the EPCOR entities. This would significantly reduce any portion attributable to CCWC. Further, Ms. Hubbard acknowledged that this would be a one-time cost.[68] Given the annual savings of $228,514 to ratepayers resulting from the over-depreciation which CCWC acknowledges in this case a one-time charge would actually result in a net savings to ratepayers. In other words, if the $500,000 was allocated over 10 systems, each system would bear a onetime cost of $50,000 which would be -expected to generate *annual* savings of $228,514. CCWC further concedes that it currently maintains the data required to apply the vintage method,[69] thereby avoiding incremental costs to start tracking this information.

As noted, Staff has identified two accounts in which over depreciation exists in this case: Account 311, Pumping Equipment, and Account 341, Transportation Equipment. As Mr. Becker explained in his Amended Surrebuttal Testimony, for Account 311, as of the end of the prior 2006 test year, the Company had recovered 55.5 percent of its investment. By the end of the current test 2012 year, the Company had recovered another 75 percent of its investment, for a total recovery of 130.5 percent of its investment.[70] For 2006 plant included in Account 341, the Company had recovered 11.3 percent of its investment as of the end of the 2006 test year. As of the end of the 2012 test year, the Company has recorded an additional six years of depreciation at 20 percent per year, for an additional 120 percent recovery.[71]

Under Staff's methodology, depreciation would cease, not when the plant is retired, but when its expected recovery has occurred. As seen from the foregoing, Staff's vintage year method is more appropriate because it allows the Company to recover the original cost of an asset, but helps to prevent customers from paying what can amount to excess recovery of investment. On the other hand, the group method allows for the over recovery of the cost of an asset by allowing plant to be

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[68] Tr. Vol. V at 800.
[69] Becker Amended Sur. Test., Ex. S-11.
[70] *Id.* at 7-8.
[71] *Id.* at 10-11.

depreciated beyond its original cost (over depreciation), and it should be noted that the Company has not asserted any under recovery of investment due to early retirements.

Staff also has some concerns about the accuracy of CCWC's final schedules and the manner in which it was able to arrive at the same Depreciation & Amortization expense as Staff. As noted, the Company has revised its depreciation rates for Accounts 311 and 341 so that its final schedules reflect amounts of Depreciation & Amortization expense which differ from Staff's depreciation expense by only $3,187. [72] Staff is concerned that the difference between the two final amounts should be much larger. First, it appears that the Company includes Schedule C-2, page 6 in support of the final depreciation expense amount of $1,688,127 on Schedule C-2, page 1. Staff is concerned that the supporting schedule shown on Schedule C-2 may contain some inaccuracies. Schedule C-2, page 6, line 2 indicates depreciation on UPIS of $2,370,807 and references Schedule C-2, page 5. C-2, page 5 shows the amount of $2,370,807, but also includes a reduction of $228,514. Schedule C-2, page 6 also reflects amortization of the AFUDC and Depreciations expense deferral of $23,586, yet the Company's rebuttal testimony indicates that this was restated as $18,276.[73]

Staff is also concerned that the composite depreciation rate applied to the Company's CIAC is overstated because the plant balances as shown on Schedule C-2, page 2 do not reflect the reduction to depreciation expense of $228,514 or any post-test year plant. Schedule C-2, page 6, line 26 shows "Total Depreciation Expense less Amortization of Contributions" of $1,779,335 which does not agree with the Company's final amount of $1,688,127, as shown on Schedule C-2, page 1. While the Company's net amount may be appropriate, it is not adequately delineated by component in its supporting schedules

Based on the foregoing, Staff believes the application of the vintage year method is not only more fair to ratepayers, but also more accurately reflects the actual and appropriate depreciation balances. Staff further contends that its recommended amount for Depreciation and Expense of

[72] Company's Final Schedule C-2.
[73] *See* Rebuttal Test. of Sheryl Hubbard, Ex. A-6 at 15.

$1,688,127 is more accurately calculated than the Company's, Staff's recommendation should be adopted.

5. *Property Tax.*

The Company proposes a 19 percent tax rate;[74] Staff and RUCO propose a rate of 18.5 percent.[75] These rates are set by statute.[76] The current rate is 19 percent. It drops to 18.5 percent for 2015, and to 18 percent for 2016. CCWC's new rates will likely go into effect in 2014[77] (though Company Witness Hubbard's projection of a May 2014 effective seems somewhat optimistic).[78] Just as Staff adjusts purchased water expense to reflect known and measurable new and higher rates, Staff proposes an adjustment for known and measurable tax rates. Even the Company acknowledges that the positions could be the same.[79] The 18.5 percent rate reflects the average of the three rates, and is fair to both the ratepayers and the Company. In contrast, Applying the highest rate, and one that is effect for only about six months, would be unfair to the ratepayers.

6. *Income Tax.*

The parties have now agreed that the state income tax rate of 6.5 percent will be utilized.[80]

III. DECLINING USAGE ADJUSTMENT

Staff agrees that a declining usage adjustment is appropriate in this case. Staff reviewed data provided by the Company which showed that consumption patterns had continued to change during the post-test year period. Such post-test year changes are not reflected in the test year results, but have occurred since the test year, therefore constituting a known and measurable change.[81]

IV. SYSTEM IMPROVEMENT BENEFITS (SIB) MECHANISM

A. Terms of the SIB.

The Company is seeking a SIB mechanism as set forth in Decision No. 73938 and is requesting that the SIB be governed by all of the conditions and requirements that are set forth in that

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[74] Tr. Vol. 1 at 183.
[75] Becker Direct Ex. S-9 at 23; Michlik Sur. Ex. R-15 at 26.
[76] A.R.S. § 42-15001.
[77] Tr. Vol. 1 at 180.
[78] *Id.*
[79] Tr, Vol. III at 557-58.
[80] Tr. Vol. 1 at 181; Michlik Dir., Ex. R-14 at 40; Becker Dir. Ex. S-9 at 24.
[81] Becker Dir. Ex. S-9 at 26.

Decision. The Company has also agreed to codify the SIB, if authorized, in a Plan of Administration ("POA") that would tailor it to the specifics of this case. As set forth in the Water POA, some of the key provisions of the SIB mechanism are as follows:

- Approval of SIB-Eligible Projects – All SIB-eligible projects must be reviewed by Staff and approved by the Commission prior to being included in the SIB surcharge. All of the projects must be completed and placed into service prior to being included in the SIB surcharge. LPSCO must file a report with the Commission every six months summarizing the status of all SIB-eligible projects.[82]

- Costs Eligible for SIB Recovery – Cost recovery under the SIB mechanism is allowed for the pre-tax return on investment and depreciation expense associated with those projects, net of associated plant retirements. The rate of return, depreciation rates, gross revenue conversion factor and tax multiplier are to be the same as established in this case.[83]

- Efficiency Credit – The SIB surcharge will include an efficiency credit equal to five percent of the SIB revenue requirement.[84]

- Surcharge Cap – The amount that can be collected annually by each SIB surcharge filing is limited to 5 percent of the revenue requirement established.[85]

- Timing of SIB Surcharge Filing – The Company: may file up to five SIB surcharge requests between rate case decisions; may make no more than one SIB surcharge filing every 12 months; may not make an initial SIB surcharge filing prior to 12 months following the effective date of a decision in this case; must make an annual SIB surcharge filing to true-up its surcharge collections; and, must file a new rate case application no later than June 30, 2019 with a test year ending no later than December 31, 2018, at which time any SIB surcharge then in effect would be reviewed for inclusion in base rates in that proceeding and the surcharge would be reset to zero.[86]

- SIB Rate Design – The SIB surcharge will be a fixed monthly charge on customers' bills, with the surcharge and efficiency credit listed as separate line items. The surcharge will increase proportionately based on customer meter size.[87]

- Commission Approval of SIB Surcharge – Each SIB surcharge must be approved by the Commission prior to implementation. Upon filing of the SIB surcharge application, Staff and RUCO would have 30 days to review the filing and dispute and/or file a request for the Commission to alter the surcharge or true-up surcharge/credit.[88]

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[82] POA Stukov Dir., Ex. S-6, Attachment C at 3-6.
[83] *Id.* at 2-3, 6-7.
[84] *Id.* at 3.
[85] *Id.* at 6-7.
[86] *Id.* at 3 - 5.
[87] *Id.* at 8-9.
[88] *Id.* at 3-5.

- Public Notice – At least 30 days prior to a SIB surcharge becoming effective, the Company is required to provide public notice to customers in the form of a bill insert or customer letter. The notice must include: the individual surcharge amount by meter size; the individual efficiency credit by meter size; the individual true-up surcharge/credit by meter size; and, a summary of the project included in the current surcharge filing, including a description of each project and its cost.[89]

In addition, the SIB requires that the Company file the following information with each SIB adjustment: (1) the most current balance sheet at the time of the filing; (2) the most current income statement; (3) an earnings test schedule; (4) a rate review schedule (including the incremental and pro forma effects of the proposed increase; (5) a revenue requirement calculation; (6) a surcharge calculation; (7) an adjusted rate base schedule; (8) a construction work in progress ("CWIP") ledger (for each project showing accumulation of charges by month and paid vendor invoices); (9) calculation of the three factor formula; and, (10) a typical bill analysis under present and proposed rates.[90] The Company also should provide current bill determinants.

The SIB also requires that the Company perform an earnings test calculation for each initial filing and annual report filing to determine whether the actual rate of return reflected by the operating income for the affected system or division for the relevant 12-month period exceeded the most recently authorized fair value rate of return for the affected system or division, with the earnings test to be: based on the most recent available operating income, adjusted for any operating revenue and expense adjustments adopted in the most recent general rate case; and, based on the rate base adopted in the most recent general rate case, updated to recognized changes in plant, accumulated depreciation, Contributions In Aid of Construction ("CIAC"), Advances in Aid of Construction ("AIAC"), and accumulated deferred income taxes through the most recent available financial statement (quarterly or longer). If the earning test calculation shows that the Company will not exceed its authorized rate of return with the SIB surcharge, the surcharge may go into effect once approved by the Commission. If the earnings test calculation shows that the Company will exceed its authorized rate of return with the implementation of the surcharge, the surcharge my not go into

[89] *Id.* at 9.
[90] *Id.* at 3-7.

effect. However, if the earnings test calculation shows the Company will exceed its authorized rate of return with the implementation of the full surcharge, but a portion of the surcharge may be implemented without exceeding the authorized rate or return, then the surcharge may be authorized up to that amount once approved by the Commission.[91]

B. Constitutionality of the SIB.

The SIB that the Company is seeking fulfills and is consistent with all of the requirements of the Arizona Constitution. However, RUCO will likely claim that the proposed SIB is inconsistent with the fair value provision of the Arizona Constitution. The SIB provides ample opportunity for the Commission to ascertain LPSCO's fair value rate base and, thereby, comply with the requirements of the Arizona Constitution.

As discussed above, the Company is required to provide updated financial information (including a balance sheet, income statement, earnings test schedule, rate review schedule, revenue requirement calculation, surcharge calculation, adjusted rate base schedule, etc.) as part of the filing package every time it seeks Commission authorization to enact a SIB surcharge. This information will enable the Commission to update the fair value rate base finding and determine the impact of the revenues (with the addition of the proposed SIB surcharge) on the Company's fair value rate of return. The SIB surcharge cannot go into effect without a Commission order and, ultimately, the Commission may terminate the SIB at any time.

RUCO cannot convincingly claim that the SIB is *per se* inconsistent with the Constitution's fair value requirements because the proposed SIB expressly requires the Company to provide updated rate base information. To argue that the proposed SIB will not comply with the Constitution implies that the Commission will ignore this information and not use it "to aid it in the proper discharge of its duties . . . ." See Ariz. Const. art XV, § 14. It is not reasonable to assume that the Commission will not act in accordance with the Constitution as to its future rate setting; instead, the opposite should be presumed.

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[91] *Id.* at 7.

RUCO may also argue, as it has in other cases where a SIB has been proposed before the Commission, that the Commission may not determine a Company's fair value rate base by relying on a recent fair value finding (from a recent rate case) as a starting point and then updating that finding with new information. However, the Commission has wide discretion to decide the method it uses to determine fair value. As our Supreme Court has recognized, "the commission in exercising its rate-making power of necessity has a range of legislative discretion . . . ." *Simms v. Round Valley Light & Power Co., 80 Ariz.* 145, 154, 294 P.2d 378, 384 (1956). In addition, the Company will be providing updated information that will allow the Commission to make new fair value findings.

In the present case, the proposed SIB would provide a means for the Commission to update the Company's fair value rate base and thereby implement a series of step increases. This ratemaking mechanism is designed to allow the Company to undertake its substantial replacement program without having to resort to a repeated series of rate cases. See *Arizona Corp. Comm'n v. Ariz. Pub. Serv. Co.*, 113 Ariz. 368, 371, 555 P.2d 326, 329 (1976), (noting that a "constant series of rate hearings" does not serve the public interest). General rate cases can be time consuming and costly, both for the Company and for ratepayers, who pay for the costs of the rate case in rates.

In *Arizona Community Action Assoc. v. Ariz. Corp. Comm'n*, 123 Ariz. 228, 599 P.2d 184 (1979), the court upheld step rate increases based on subsequent additions to the company's plant. Specifically, the company was granted a six percent rate increase in year 1; in years 2 and 3 the company was permitted to increase its rates by a maximum of five percent per year if certain conditions were met. For the step 2 increase, the company was permitted to increase its rates by the lesser of five percent of gross operating revenues or a revenue deficiency,

> calculated by first totaling (1) the amount of electric properties placed in service since the prior rate increase, (2) construction work in progress for the preceding calendar year for any plant for which construction work in progress had previously been included in rate base, and (3) construction work in progress during the preceding calendar year for plants scheduled to go into service within two years. 123 Ariz. at 229, 599 P.2d at 185 (emphasis added).

The sum of these amounts was then to be multiplied by the rate of return on electric plant authorized by the Commission. The court upheld this portion of the Commission's order, stating,

> The Commission stated in the decision under attack that it . . . would initiate innovative procedures in an attempt to deal promptly and equitably with increasingly complex regulatory matters. At the Step I hearing, the Commission fulfilled the constitutional requirements of art. 15, §§ 3, 14, which mandate a finding of the fair value of all property at the time of fixing a rate.[92]

The court further indicated that it did not "find fault" with the Commission's efforts to avoid a "constant series of extended rate hearings . . . ." 123 Ariz. at 231, 599 P.2d at 187. Finally, the court noted that the Commission's order in the rate case "resulted in a determination of fair value [,]" and that further adjustments between rate cases "were adequate to maintain a reasonable compliance with the constitutional requirements if used only for a limited period of time." *Id.* (emphasis added).

The proposed SIB has been developed in the context of a full rate case in which the Commission has determined the Company's fair value rate base and approved the specific plant projects to be included in the SIB. The SIB will be limited to projects that replace plant used to serve existing connections. The SIB further provides for the retirement (removal from rate base) of the plant that has been replaced. Therefore, the new plant will not generate a new revenue stream.

As noted earlier, the amount to be collected by a SIB surcharge is capped at five percent of the revenue requirement as established in Decision No. 73736, Phase 1 of Docket No. W-01445A-11-0310. These amounts are subject to true-up, either in the annual SIB filings or in the Company's next full rate case. Finally, the Company will have to file a full rate case by June 30, 2019 with a test year ending December 31, 2018. These features serve to ensure that the resulting rates will be just and reasonable and that the SIB will be used only for a limited period of time.

In *Community Action* the step increase mechanism was ultimately set aside by the court. While this is ultimately true, it is important to note that the court did not find fault with the step increases *per se*; instead, it found that the step increase was triggered solely on a percentage of return on common equity, which fell largely within the Company's control. For this reason, it could not be the "sole criterion" for triggering the step increase. *Community*, 123 Ariz. at 231, 599 P.2d at 187.

The instant SIB, however, differs from the step increase mechanism in *Community Action* in that there isn't any "test" subject to control by the Company. In fact, there is no guarantee that the

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[92] *Scates v. Ariz. Corp. Comm'n*, 118 Ariz. 531, at 537, 578 P.2d 612, at 618 (App. 1978).

Commission will authorize each increase as it depends on whether it is determined that the Company is earning more than its authorized rate of return. Further, the Commission may suspend the SIB.

Moreover, each annual SIB surcharge requires Commission approval in order to take effect. The Company is required to provide information with each SIB filing that will allow the Commission to determine the impact of the new plant on the Company's fair value rate base and consider the resulting impact on the Company's rate of return. Arizona case law does not require more.

RUCO may argue that the SIB is an example of "single issue ratemaking" and that such an approach is prohibited by *Scates v. Ariz. Corp. Comm'n*, 118 Ariz. 531, 578 P.2d 612 (App. 1978). That case, however, focuses upon the requirements of Article XV, section 14 of the Arizona Constitution, which pertain to determining fair value rate base:

> "We . . . hold that the Commission was without authority to increase the rate without any consideration of the overall impact of that rate increase upon the return of . . . [the utility], and without, as specifically required by our law, a determination of . . . [the utility's] rate base."[93]

However, Article XV, section 14 is silent as to "single issue ratemaking." Wherever that term may have originated, it is not contained in the Arizona Constitution.

The *Scates* court was careful to make it clear that a full rate case is not required for every increase in rates.[94] The court noted that "[t]here may well be exceptional situations in which the Commission may authorize partial rate increases without requiring" a full rate case. Therefore, the case does not preclude the Commission from updating previous findings based upon new information.[95]

In recognition of the *Scates* decision, the proposed SIB clearly requires the Company to submit such information. There is no reason to presume that the Commission will not appropriately consider this information when evaluating each SIB surcharge filing. Even if the Commission were to fail to do so, the time for a challenge is after the Commission has acted. It is inappropriate to

[93] *Id.*
[94] *Id.*
[95] *Id.*

assume that the Commission will fail in its future constitutional duties, especially when the proposed SIB mechanism contains all the required ratemaking elements.

V. RATE DESIGN

CCWC conducted a cost of service study, the methodology of which Staff has found acceptable.[96] As the Company acknowledges, a cost of service study is a guide only.[97] It need not be strictly adhered to, and many other factors, including conservation, will affect the rate design.[98] For that reason, the rates adopted often do not cover the cost of service for each customer class as established by the cost of service study.[99] Typically, this is seen in inverted tier rates adopted in an effort to promote conservation of water.

In this case, the primary differences between Staff's rate design and that of the Company are the amount of the monthly minimum charge and the extent to which it recovers the Company's fixed charges and the commodity charge for the first tier of usage.[100] The Company's final proposed monthly minimum charges by meter size are as follows: 3/4-inch $21.50, 1-inch $35.91, 1 1/2-inch $72.82, 2-inch $144.92, 3-inch $229.84, 4-inch $359.12, 6-inch $718.25, 8-inch $1,149.19, 10-inch $1,651.96, and 12-inch $3,088.45. Customers who qualify as low income with 3/4-inch and 1-inch meters would qualify for a discount of $7.50[101] per month from the monthly minimum. Zero gallons are included in the monthly minimum charge for all customers.[102]

The Company proposes a 3-tier inverted residential commodity rate for only the 3/4-inch customers of $2.9726 per thousand gallons for zero to 3,000 gallons, $3.8215 per thousand gallons for 3,001 to 9,000 gallons, and $4.6703 per thousand gallons for any consumption over 9,000 gallons. The other proposed residential commodity rate tiers vary by meter size, but are $3.8215 per thousand gallons for the first tier and $4.6703 per thousand gallons for any consumption over the first tier. The Company is proposing an increase in its meter and commodity charges for commercial,

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[96] Tr. Vol. III at 587-88.
[97] *Id.* at 546.
[98] *Id.*
[99] *Id.* at 546.
[100] *Id.* 550.
[101] Broderick Dir. Test., Ex. A-3 at 12.
[102] Company's Final Schedules H-1, H-2, H-3, and H-4.

irrigation and hydrant customers. The Company is also proposing increased monthly and commodity charges for private fire service which does not vary by meter size.

Staff's recommended final rates and charges are presented on Schedule GWB-1. Staff's recommended monthly minimum charges by meter size are as follows: 3/4-inch $19.25, 1-inch $32.11, 1 1/2-inch $64.21, 2-inch $102.73, 3-inch $205.47, 4-inch $321.04, 6-inch $642.10, 8-inch $1,027.434, 10-inch $1,476.61, and 12-inch $2,761.00. Customers who qualify as low income with 3/4-inch and 1-inch meters would qualify for a discount of $7.50 per month from the monthly minimum. Zero gallons are included in the monthly minimum charge. For the 3/4-inch residential customers, Staff recommends a 3-tier inverted rate design with commodity charges of $2.00 per thousand gallons for zero to 3,000 gallons, $3.460 per thousand gallons for 3,001 to 9,000 gallons, and $4.169 per thousand gallons for any consumption over 9,000 gallons. Staff's recommended larger residential, commercial, irrigation, and hydrant commodity rates have two tiers and vary by meter size, set at $3.460 per thousand gallons for the first tier and $4.169 per thousand gallons for any consumption over the first tier. Staff recommends increases in meter and commodity charge for commercial, irrigation and hydrant customers. Staff recommends increasing the monthly charge for fire sprinkler service to the greater of $10.00 or 2 percent[103] of the monthly minimum charge for that meter size with no commodity charge. Staff's first tier is discounted to increase the affordability of non-discretionary usage. In Staff's final schedules, Staff increases the monthly minimum charge to 40.5 percent and increases the second and third tiers of the commodity charge to make up the difference.[104]

The Company proposes to increase the establishment service charge from $25 to $60.[105] Staff compared this case to other EPCOR entities and recommends a $30 charge which is within the range of other EPCOR Divisions with more current rates. Although the Company asserted that the $60

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[103] Staff's Final Schedules, GWB-1.
[104] Tr. Vol. V 881-82.
[105] Hubbard Reb. Test., Ex. A-6 at 29.

charge represented the actual cost of this service, it did not provide sufficient information to support its position.[106]

The Company proposes to increase the reconnection (delinquent) service charge from $35 to $60. Staff recommended a $35 charge which is also within the range of other EPCOR Divisions with more current rates. Here, too, although the Company asserted that the $60 charge represented the actual cost of this service, it did not provide sufficient information to support its position.

The Company proposed to decrease the meter test service charge from $35 to $30. Staff recommends the meter test charge to remain at $35.

The Company has proposed to increase its current Establishment (After Hours) and its Reconnection (Delinquent). Staff agrees that an additional fee for service provided after normal business hours is appropriate when such service is at the customer's request or for the customer's convenience. Such a tariff compensates the utility for additional expenses incurred from providing after-hours service. Moreover, Staff concludes that it is appropriate to apply an after-hours service charge in addition to the charge for any utility service provided after hours at the customer's request or for the customer's convenience. Therefore, Staff recommends elimination of the Company's current Establishment (After Hours), and Reconnection

Instead of (Delinquent) After Hours charges, Staff continues to recommend the creation of a separate $35 After-Hours Service Charge. For example, under Staff's proposal, a customer would be subject to a $30 Establishment fee if it is done during normal business hours, but would pay an additional $35 after-hours fee if the customer requested that the establishment be done after normal business hours.

VI. REVENUE REQUIREMENT AND COST OF CAPITAL

Staff and RUCO recommend the adoption of a hypothetical capital structure for the Company of 60.0 percent equity and 40.0 percent debt.[107] The Company advocates that its actual capital structure be utilized which is 82.2 percent equity and 17.8 percent debt. Staff's final recommended

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[106] Hubbard Reb. Test., E. A-6 at 29.
[107] Cassidy Direct Test., Ex. A-15 at 8.

cost of equity ("COE") is 9.6 percent, the cost of debt ("COD") is 5.2 percent, and the final recommended overall rate of return ("ROR") is 7.9 percent.[108] RUCO's final recommended COE is 9.35%, the COD 5.92% and the ROR is 7.98 percent.[109] The Company's final recommended COE is 10.5 percent, their COD is 5.97 and the ROR is 9.85 percent.[110] However, in the financing application that was recently had approved in Decision No.74388, the Company agreed to Staff's COD.[111] According to Staff's calculations the Company's change to a COD of 5.2 would alter their final ROR to become 9.73 percent.

A. Hypothetical Capital Structure.

Staff recommends a hypothetical capital structure consisting of 40.0 percent debt and 60.0 percent equity to give recognition to CCWC's reduced exposure to financial risk relative to Staff's proxy group.[112] Staff's sample average capital structure consists of 50.3 percent debt and 49.7 percent equity. CCWC's capital structure is equity rich, consisting of 17.8 percent debt and 82.2 percent equity. Therefore, CCWC has less exposure to financial risk, which results in a lower cost of equity.[113] Staff's hypothetical capital structure gives recognition to this circumstance and encourages the Company to move towards a more balanced capital structure in the future. A capital structure with a disproportionately high amount of equity will cause higher rates being charged to customers, where a more balanced approach will get the same level of service for a lower rate.[114]

RUCO's expert also believes that a hypothetical capital structure is the best option. In his testimony David Parcell states that he does not believe it is proper to use the Company's requested structure given that is it so greatly different compared to other EPCOR subsidiaries and to the proxy companies. Although the Company has expressed in its opposition to Staff's recommendation, that notice of this concern was inadequate, the Company's capital structure has been of concern for some time. Mr. Parcell was Staff's surrebuttal witness in CCWC's previous rate case and expressed that

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[108] Cassidy Sur. Test., Ex. A-16, Executive Summary.
[109] RUCO Final Schedule JMM-1.
[110] Ahern Rebuttal Tesd., Ex. A-11 at 3-6.
[111] Decision No. 74388
[112] Cassidy Direct Test., Ex. A-14 at. 9-10.
[113] *Id.*
[114] *Id.* at 10

his feelings there as well as here that a case can be made that CCWC's capital structure should be that of its consolidated parent.[115] Initially in this case, Mr. Parcell had not proposed a hypothetical capital structure. However, upon reviewing the responses to RUCO data requests 6.03 and 11.02 where the capital structure of CCWC and other EPCOR subsidiaries are listed and compared, and based on his work for Staff on the previous CCWC rate case, he reconsidered his position.[116] In addressing the issue at hearing, Mr. Parcell testified that when "a utility is so much out of whack...with other utilities...you just can't ignore having an equity ratio that's that much higher."[117]

There is an issue of fairness in this situation in that CCWC's capital structure is radically different than that of its fellow subsidiaries that the rate payers are the ones that will bear the cost of that difference. The cost of equity being higher than debt, using the Company's may permit the Company to recover the more expensive cost of equity from ratepayers while allocating the less expensive cost of debt to the parent company's shareholders. Staff's approach will result in a more balanced treatment of the capital structure which weighs the benefits between the Company and the rate payer.

B. The Commission Should Continue to Reject CCWC's Small Firm Risk Adjustment.

CCWC contends its small size makes it more risky in comparison to the large publicly traded utilities in the proxy group and therefore CCWC requires a business risk adjustment as compensation.[118] However, this argument should be rejected for several important reasons.

First, CCWC is not an unassociated small company; rather, it is a subsidiary of a much larger parent corporation, EPCOR Utilities, Inc., which ultimately is owned by the City of Edmonton, Canada. As a result, CCWC is able to avail itself of other resources and capital markets to which most truly small companies do not have access. Staff believes that any risk that would be reflected in the Company's beta as a result of its "small" size is dissipated by CCWC's association with its much larger parent company; therefore, no additional adjustment is necessary.

[115] Tr. Vol. II at 313-314.
[116] Parcell Sur. Test., Ex. R-8 at 18-19.
[117] Tr. Vol II at 285.
[118] Ahern Direct Test., Ex. A-10 at 44-46.

Second, any risk associated with the size of a company is an unsystematic or "firm specific risk." Investors are not concerned with "firm specific risk" because investors can eliminate that risk by holding diverse investment portfolios.[119] Therefore, any adjustment to COE to account for the Company's purported "firm specific risk" is unwarranted.[120]

Third, it has been the sound policy of the Commission to appropriately and continually reject such an adjustment.[121] Indeed, the Company has failed to cite any Commission decisions where a small company risk premium was adopted. Staff recommends the Commission likewise reject this adjustment in this case.

RUCO advocates against the Small Firm Adjustment stating that it is not justified and not appropriate.[122]

VII. CONCLUSION

For the foregoing reasons, Staff urges the adoption of its position herein and the calculations contained in its Final Schedules submitted March 7, 2014.

RESPECTFULLY SUBMITTED this 7th day of April, 2014.

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Original and thirteen (13) copies of the foregoing filed this 7th day of April, 2014, with:

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119 Cassidy Direct Test., Ex. A-14 at 15.
120 *Id.* at 41.
121 *Id.* at 41.
122 Parcell Sur. Test., Ex. R-8 at 13.

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